

Date Mailed March 25, 1998

BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN

Application of Wisconsin Fuel and Light
Company as a Natural Gas Utility,
for Authority to Increase Natural Gas Rates

6640-GR-106
(Part B)

**FINDINGS OF FACT, CONCLUSIONS OF LAW,
AND ORDER**

Proceedings

On March 2, 1995, Wisconsin Fuel and Light Company (applicant) filed an application with the Commission under ss.196.03, 196.20 and 196.37, Stats., for authority to increase rates for natural gas service and simultaneously institute a radically different rate design. The Commission bifurcated the rate case, first addressing the rate increase issues in Part A of this docket. On October 11, 1995, the Commission authorized Wisconsin Fuel and Light Company to increase rates in the amount of \$1,099,800 for the test year ending August 31, 1996.

Because applicant's proposal represented a significant change in how revenues are collected and was relevant to issues being considered by the Commission in the generic restructuring docket 05-GI-108, the order in Part A established two conditions which had to be met prior to the Commission's consideration of applicant's rate design in Part B. The first requirement was that an order had to be issued in Phase I of docket 05-GI-108 and that staff complete its analysis of the issues in Phase III¹ of docket 05-GI-108 prior to addressing Part B of this docket. An order in Phase I of docket 05-GI-108 was issued December 4, 1995. Staff analysis of Phase III was completed and a Commission order was issued June 9, 1997.

The Commission also required applicant to make adequate efforts to inform, educate and evaluate any responses from its customers regarding its proposed rate design prior to Commission

¹ When the order in Part A of this docket was issued, it was assumed that the relevant issues in the generic docket 05-GI-108 would be addressed in Phase II, however, Phase II became the Standards of Conduct order and the relevant issues to this case then became Phase III issues. The main issues in Phase III were: 1) what standards to apply to determine when a market is sufficiently competitive to be deregulated; 2) whether certification of natural gas marketers is necessary; 3) what price disclosure requirements may be necessary; and 4) identifying and addressing barriers to competition in developing natural gas markets in Wisconsin.

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consideration of Part B. Applicant's efforts consisted of discussions with staff, a series of four bill inserts, a newspaper insert discussing unbundling issues and its rate proposal, and public meetings in both service territories. Applicant hired an independent research firm to evaluate the effectiveness of its efforts. Public meetings were repeated prior to each public hearing held in Wausau and Manitowoc. For customers using more than 50,000 therms annually, applicant held information meetings and had direct customer contact.

By letter dated July 22, 1996, applicant requested that the Commission proceed with Part B of this docket. Part B is revenue neutral,² therefore income statement, rate base, cost of capital and rate of return issues are not directly part of the case. Part B is solely to address applicant's rate design proposal. The Order in Phase I of docket 05-GI-108 had been issued and staff's progress in the development of issues for Phase III was sufficient to move forward with applicant's request. Therefore, at its open meeting of November 7, 1996, the Commission reviewed the educational efforts regarding applicant's proposed rate restructuring and found that the independent research showed that there remained a significant lack of understanding of applicant's proposed rate design and that the information provided did not readily give individual ratepayers the ability to see how they would be affected by the proposed changes. Accordingly, the Commission authorized proceeding with Part B of the rate filing, but directed applicant to undertake additional educational efforts sufficient to ensure that the utility's customers were provided with enough information to make their own assessments of the impact of the company's proposed rate design and to understand how to participate in the Commission's proceedings.

On January 15, 1997, applicant filed exhibits and testimony with respect to Part B of this docket. In addition to its original rate design proposal, applicant filed an alternate proposal with a modified rate design structure to address some of the negative rate impact concerns expressed by customers and Commission staff. A prehearing conference was held on July 25, 1997, to identify issues and active participants, as well as to set dates, times and locations for public hearings in Wausau and Manitowoc and technical hearings in Madison. In addition, dates were specified for filing additional testimony and exhibits, and to accommodate data requests.

Pursuant to due notice, technical hearings were held on November 7, 1997, in Madison before Examiner John Crosetto. Also pursuant to due notice, public hearings were held on November 10, 1997, and November 11, 1997, in Manitowoc and Wausau respectively, before Examiner Donna Paske. Public informational meetings preceded both public hearings.

The parties for purposes of review under s 227.47, Stats., are listed in Appendix A of this order.

² "Revenue Neutral" means that the total amount of revenue collected under any new rate design would be the same as that collected under the existing rate design.

FINDINGS OF FACT

THE COMMISSION FINDS:

Applicant and Its Business

Wisconsin Fuel and Light Company is a public utility as defined in s. 196.01, Stats., engaged in the purchase, distribution and sale of natural gas to approximately 48,000 customers in Manitowoc, Wausau and surrounding areas.

Natural Gas Rates

Cost of Service Study

Applicant made only minor changes to the cost of service study used as the basis for rate design in Part A of this docket. No party challenged the underlying cost of service study. The Commission finds it to be a reasonable basis for the development of rate design in this case.

Basic Distribution Charge - Fixed Components

Under the distribution function applicant proposed three different fixed charge components, each of which are addressed below. Parties to this case and individuals that attended the public meetings and hearings tended to discuss the three fixed components collectively, and generally did not address each component on a separate basis. The collective fixed charge proposed by applicant and applicable to a residential space heating customer, is \$29.39 per month under applicant's original proposal and \$18.70 per month under the alternate rate design proposed by applicant. For comparison purposes, the fixed charge component for a residential space heating customer under the rate design authorized in Part A of this proceeding is \$5.00 per month.

When considering applicant's proposal to depart dramatically from traditional ratemaking in which most costs are collected on a volumetric or usage basis, and move to a rate design which is designed to recover most of the costs that do not vary with usage on a fixed basis, the Commission carefully weighed the evidence in the record. The Commission paid particular attention to individual bill impacts for all classes of customers, customers' ability to control their bill, aligning cost recovery with cost incurrence, conservation effects, and the economics of rates designed more toward load factor efficiency. The Commission finds that applicant's proposed rates, as adjusted by the Commission, strike a balance between conservation and economic efficiencies and hence retain the Commission's current policy of balancing economic interests with the public interest of conserving nonrenewable resources. The Commission also finds that the resulting rates will adequately mitigate bill impacts.

Customer Charge. Applicant's rate design includes a fixed customer charge of \$7.60 per month applicable to all customers, regardless of customer class status. This largely represents the cost associated with billing and maintaining customer records. Applicant argued that since these costs do not materially vary by customer class or by usage billing these costs as a flat monthly charge recovers the costs equitably. The Commission finds that a fixed customer charge of \$7.60 per month for all customers reasonably recovers fixed cost components associated with each customer, is an identifiable cost component and is reasonable.

Enhanced/Other Services. To be consistent with the cost functionalization categories the Commission directed in the Phase I Order in docket 05-GI-108, applicant developed the Enhanced/Other Services function and segregated conservation-related costs and miscellaneous customer services in this category. Applicant proposed to collect these expenses as a fixed monthly charge of \$2.5725 for all customers, regardless of customer class designation. The Commission finds that these costs are not related to usage and that customer conservation efforts generally do not lessen or eliminate the distribution-related costs of providing natural gas service. Accordingly, the Commission finds applicant's proposal to recover these costs on a fixed monthly charge basis to be reasonable and that the resulting rate of \$2.5725 is reasonable.

Facilities Charge. Applicant proposed that a facilities charge of \$6.5488 per dekatherm of demand be applied to the class average demand for smaller customers (customers using less than 50,000 therms annually). For customers using more than 50,000 therms annually, the applicant proposed that the facilities charge of \$6.5488 be applied to individual customer demand. This charge per unit of demand was derived by taking most of the remaining distribution, or non-gas costs, that do not vary with usage, dividing that number by the total non-coincident demand, and finally by dividing that quotient by 12 to create a monthly rate. Exhibit 1 and the supporting testimony demonstrated that the applicant's revenues in any month bear little relationship to the level of costs, primarily because most costs do not vary with usage. The record demonstrates that distribution costs do not relate to the amount of energy used by a customer, but are more closely related to the customer's maximum potential load, and are fixed in nature.

The Commission finds that for large customers who will have individually computed facilities charges based on individual demand characteristics, applicant's proposed facilities charge is reasonable. Customers will be charged a facilities charge based on the demand that individual customers put on the system. In this way, these customers will have more control over how they can affect their bill. In making its determination, the Commission took customer bill impacts and potential effects on future conservation into consideration. The customers that will experience the largest bill increases under the new rate design are the customers with the poorest load factors, who, for years have reaped the benefit of class average rates, not justified from an individual cost causer/cost payer perspective. Although individual meter usage levels may result in significantly higher bills under the new rate design, many large users of gas have several meters and the higher bills from one or more meters are often

offset by significantly lower bills under the new rates for other meters. All customers will have approximately nine months before the new rates are effective. This allows customers the opportunity to alter their usage levels or patterns to mitigate any negative impacts. Because these customers' demand billing determinants will be re-established annually, there will continue to be an incentive for customers to perform conservation measures.

The Commission finds that the applicant's proposed facilities charge is not appropriate for small volume customers (customers using less than 50,000 therms annually). For these customers, applicant's proposed facilities charge is based on class average demand. Under this proposal, an individual customer could do little to affect this portion of his or her bill since the class average demand will not be affected significantly by the actions of an individual customer. This rate design would diminish the economic incentive for individual customers to undertake conservation efforts. In order to ameliorate this disincentive and to give individual small volume customers greater control over the facilities charge they are required to pay, the Commission finds that it is reasonable that 50 percent of the fixed facilities rate of \$6.5488, or \$3.2744, should be converted to a volumetric rate for all customer classes in which the facilities charge is applied to a customer class average demand. Customers using less gas than the class average will see bill increases under WFL's proposals, however the conversion of 50 percent of the facilities charge to a volumetric rate will have a mitigating effect on the increases.

As discussed above, applicant's proposal is a substantial departure from traditional gas rate design. The Commission finds it to be a rational approach, taking into consideration the matching of revenue recovery and cost causation, load factor efficiencies, customers' ability to control their bills, customer conservation incentives and the specifics of WFL's service territory.³ Allowing 50 percent of the facilities charge to be billed on a fixed basis and moving the remaining 50 percent to a volumetric rate enhances the ability to easily move in either direction, toward a more volumetric approach or even further toward a fixed charge approach, in future cases if appropriate based on actual experience gained from this case, future policy direction, and the results of further unbundling the cost of service.

Basic Distribution Charge - Variable Component

Applicant's proposal includes one volumetric component in the basic distribution charge. This charge captures distribution-related expenses, such as odorant, that vary with usage. It also includes costs that are not necessarily variable with usage, but have traditionally been collected on a usage basis and for which applicant has not proposed a change at this time. This includes uncollectible accounts expense, the remainder assessment, the gross receipts tax, and one-half of income taxes and return. The effect of recovering these expenses in a volumetric-based charge is to retain some measure of weather

³ WFL is a medium sized natural gas utility consisting of two urban areas in which a significant number of customers use a minimal amount of natural gas, less than 600 therms annually. The level of uncollectible accounts is relatively low. There are a manageable number (less than 200) of large customers that will have individually computed demand billing determinants.

or usage sensitivity in the earnings of the utility. The substantially higher total fixed charges greatly diminish the volumetric charge to a proposed rate of \$0.0110 for all customer classes using greater than 50,000 therms annually. The Commission's decision to convert 50 percent of the facilities charge to a volumetric basis for all customers, except those using greater than 50,000 therms annually, will increase the proposed volumetric distribution charge to these customer classes by \$0.0406 to a total of \$0.0516 per therm. The Commission finds applicant's proposed volumetric rate for large customers to be reasonable. For all other customer classes the Commission finds applicant's proposal, as adjusted to include 50 percent of the facilities charge, to be reasonable.

Merchant Function Charge

Applicant's original proposal would collect capacity-related expenses on a fixed basis based on class-average demand for smaller customers and based on individually computed demand for large customers using more than 50,000 therms annually. This is the same method that applicant proposed for recovery of the distribution facilities costs.

In its alternate proposal, applicant modified its original proposal by converting the capacity-related expenses to a volumetric rate for customers using less than 50,000 therms annually. Applicant stated that its alternate proposal was submitted to alleviate staff concerns with the bill impacts associated with the original proposal. Applicant's alternate proposal continues to recover capacity-related expenses from its large customers on a fixed basis based on individually computed non-coincident demand levels. Applicant stated that because bills for these large customers are computed based on individual demand, they become a type of load factor rate and the individual pieces (i.e., distribution and merchant function charges) that make up the rate structure cannot be modified independently. To do so results in a perverse rate structure, especially for high load factor customers. The Commission, therefore, addressed the reasonableness of the rate design for large customers with individually calculated demand levels independently from the smaller customers who are subject to a rate design based on class averages.

Gas supply continues to be billed volumetrically for all customer classes and therefore was not an issue in this proceeding.

Applicant proposed another merchant volumetric charge which is referred to as the competitive supply function and includes the costs associated with the gas procurement function. In prior rate cases such costs were recovered through distribution-related cost categories. This functional category is billed volumetrically for all customer classes, is consistent with Commission direction in docket 05-GI-108, Phase I, and was not contested.

The Commission finds that the merchant function cost categories and rate structure proposed in applicant's alternate proposal and discussed above are reasonable and just.

Waiver for Demand Billing Determinant

An intervenor, the Wisconsin Paper Council, suggested that when computing the demand component billing determinant for large customers who also use alternate energy sources, the gas spike occurring when the alternate equipment is out of service should not be considered. The Commission determined that it is appropriate for applicant to explore mitigation strategies for customers in this situation. A waiver for some level of increased demand when the alternate energy equipment is not available is one strategy that should be pursued, but any waiver should be very specific, well defined, and narrowly focused. Should a waiver be developed, it should not have material negative effects on other ratepayers. Proposed tariff language for any such waiver should be approved by the Commission prior to January 1, 1999. Applicant could also work with individual customers on the development of load management strategies.

Tariff Changes

Several tariff changes were requested by applicant. These requested changes were uncontested.

Reconnection Fee

The Commission finds it reasonable and just to increase the reconnection fee applicable to customers that request a disconnect and a subsequent reconnect within 12 months. This higher fee will discourage customers with sporadic or seasonal use from frequently disconnecting and reconnecting their natural gas service in order to avoid the monthly fixed charges.

Large Customer Overrun Service

The Commission finds it reasonable and just to implement a overrun service for large customers with customized billing determinants. This overrun service will encourage customers to agree to the proper demand level by charging an overrun fee for each day they exceed their contractual maximum daily level.

Peak Shaving Transportation Credit Rate

The Commission finds it reasonable and just to increase the peak shaving transportation service tariff (PSTS-1) credit rate. This increase to the credit offsets the increased rate customers will pay under the new rate structure.

Financial Implications Of Proposed Rate Design

While the revenue requirement was determined in Part A of this docket and was not to be reconsidered in Part B, evidence on the financial implications of the proposed rate design was presented by staff and two intervenors.

Staff testified that applicant's proposal to collect more of its fixed costs through fixed charges would allow the company to increase its use of debt in its capital structure and lower its overall cost of capital. Since customers vary their usage as a result of factors such as weather and the economy, recovery of fixed costs by means of fixed charges, and variable costs by volumetric charges, would decrease the amount of variability in the company's revenue and earnings flows from current levels. The decrease in the variability in its earnings flows would in turn allow the company to utilize proportionally more debt in its capital structure. The ability to use less equity financing and more tax-advantaged debt financing would allow the company to lower its overall, or economic, cost of capital.

Intervenor Wisconsin Paper Council testified that applicant's proposal to shift the recovery of all its fixed costs from the current blend of fixed and variable charges to one which relies only on fixed billing components substantially increases the portion of applicant's income which would be produced regardless of how much natural gas the utility actually sells. The impact on the allowable return on equity which results from this decrease in the utility's business risk should be investigated further.

Intervenor Wausau Paper Mills Company testified that the reallocation of fixed costs under applicant's proposal may reduce the utility's business risk in the future and that because of this, a review of the utility's allowed return on equity at some future time may be appropriate.

In cross examination, applicant agreed that its proposed rate design provided more predictability in its revenue flow, but was uncertain that it substantially or measurably reduced its business risk.

The Commission finds that a rate design which recovers more of the fixed costs through fixed charges and variable costs by volumetric charges would decrease the amount of variability in a utility's revenue and earnings flows from current levels and would correspondingly decrease business risk for that utility. The Commission determined that a review of the utility's allowed return on equity, after experience with the authorized rate design had been gained, would be appropriate. The Commission further determined that, given inflation and the time elapsed between Part A and implementation of the authorized rate design, no future review of the utility's allowed return on equity would be ordered at this time.

In addition, the Commission finds that the proposed rate design should not cause any change in the quality of service.

Use of Algorithms in Lieu of Telemetering Equipment

Intervenor Enron Capital Trade and Resources Corp. (Enron), requested that the Commission direct applicant to use algorithms rather than telemetering equipment in offering transportation service to small and medium sized customers. Enron argued that applicant's current requirement that all transportation customers be telemetered and pay for such equipment is a significant barrier to entry for small to medium sized customers. Applicant opposed the use of algorithms because they have not yet achieved confidence in applying them for billing purposes, especially billing imbalances, overruns, and penalties.

The Commission determined that the record was not fully developed with regard to this issue and that it is better suited as a generic restructuring issue.

Conservation Escrow

Applicant is currently amortizing past over-spent conservation funds. The Commission finds it reasonable that this amortization end because continued amortization will only result in a large amortization in the opposite direction in the next rate case proceeding. The revenues produced by the rates authorized by this order are net of this conservation amortization level, therefore it is reasonable that this amortization end effective with implementation of the rates authorized herein.

Load Management

Commission staff testified that if the Commission approves a significant shift in how revenues are collected, more attention should be paid to load management strategies. Staff suggested that with the higher level of fixed charges, customers should be given a choice to affect those costs by how they use energy. The Commission finds that the record with respect to this issue was not adequately developed; there is little information on what could be accomplished or how it could be achieved. Development of load management strategies would require a major research effort on the part of the applicant since there are no known programs that could readily be instituted. The Commission determined that it was not reasonable to require applicant to undertake such a significant research project and that such a project is more appropriately undertaken on a more generic basis or by a energy research facility.

Bill Components

Applicant proposed simplifying customers' bills by showing a composite of the fixed charges and the variable charges. Staff testified that individual components should be shown on the bill so that customers can identify and understand the composition of their bills and to prepare customers for further unbundling in the future. The Commission determined that individual components should be shown on customer bills and that, at a minimum, the breakdown should be similar to what the Commission has

required for other gas utilities in recent cases. Although individual components should be shown, the current bill breakdown, namely separating the base cost of gas from the monthly purchased gas adjustment factor, need not be separate components under the new billing format. The Commission directed applicant to work with staff to develop an appropriate bill format.

Effective Date of Approved Rate Design

The Commission determined that an appropriate effective date for implementation of the new rate design authorized by this order is January 1, 1999. This delayed implementation allows applicant more time to educate its customers concerning its new rate structure and how it will affect customer classes and individual customers. Customers using substantially less than the class average will experience negative bill impacts as will low load factor customers using more than 50,000 therms annually. The January 1, 1999, implementation date provides a transition period to help mitigate negative bill impacts. These customers will have a better opportunity to mitigate bill increases they would otherwise realize by changing their natural gas usage levels or patterns prior to January 1, 1999. During this transition period WFL is encouraged to educate its customers concerning its new rate structure and steps customers may be able to take to minimize individual increases. At a minimum, the Commission finds that WFL should, within 45 days of the issuance of this order, or with the next billing cycle, inform all customers of the authorized rates and the anticipated effective date, and include a telephone contact so that customers can get assistance regarding ways to mitigate individual bill increases.

Intervenor Wisconsin Paper Council proposed a transitional rate freeze for customers with significant bill increases delaying implementation of such increases to provide time to take steps to mitigate bill impacts. The Commission rejected this proposal because it is one-sided, allowing decreases to some, while not allowing offsetting increases to others. The rate structure would not be revenue neutral for this period of time and would not be fair or equitable.

ENVIRONMENTAL IMPACT

This is a Type III action under s. PSC 4.10 (3), Wis. Adm. Code. No unusual circumstances suggesting the likelihood of significant environmental consequences have come to the attention of the Commission. Neither an environmental impact statement under s. 1.11, Stats., nor an environmental assessment is required.

ULTIMATE FINDINGS OF FACT

THE COMMISSION FINDS:

1. That the rates identified in Appendix B are just and reasonable and should be implemented.
2. That it is appropriate for applicant to explore mitigation strategies for customers who use alternate energy and will be subject to billing based on the high level of demand used when the alternate energy equipment is not available.
3. That the tariff changes proposed by applicant addressing reconnection fees, an overrun service and the peak shaving credit as discussed in the above findings are just and reasonable.
4. That a rate design which collects more of the fixed costs through fixed charges and variable costs through volumetric charges decreases business risk.
5. That while a review of the utility's allowed return on equity would be appropriate in the future, no review would be ordered at this time.
6. That it is reasonable for applicant to stop amortizing past over-spent conservation.
7. That it would be unreasonable to require applicant to undertake a research project on effective load management strategies for natural gas users.
8. That it would be reasonable for applicant to work with Commission staff to develop an appropriate bill format which will identify more of the rate structure billing components.
9. That for the reasons discussed in the Findings of Fact a reasonable effective date for the tariffed rates and services authorized herein is January 1, 1999.

CONCLUSION OF LAW

THE COMMISSION CONCLUDES:

That it has jurisdiction under ss.196.03, 196.20, 196.37, 196.395 and 196.40, Stats., to enter an order authorizing Wisconsin Fuel and Light Company to place in effect the rates and rules for gas utility service set forth in Appendix B attached hereto and made a part hereof and that such rates and rules are just and reasonable.

ORDER

THE COMMISSION ORDERS:

1. That Wisconsin Fuel and Light Company is authorized to apply the rates as specified in Appendix B and attached hereto to natural gas service under the jurisdiction of this Commission.
2. That Wisconsin Fuel and Light Company is authorized to file tariffs consistent with the rates specified in Appendix B and as discussed in the Findings of Fact and to file tariff changes for reconnection fees, an overrun service and the peak shaving transportation credit as discussed on the Findings of Fact.
3. That the effective date of the rates and rules specified in Appendix B is January 1, 1999, provided that such rates and rules are filed with the Commission and placed in all offices and stations of the utility by that date. If the authorized rates and rules are not placed in all offices and stations by January 1, 1999, the rates and rules shall become effective on the date the rates and rules are placed in all offices and stations.
4. That Wisconsin Fuel and Light Company shall prepare bill inserts which appropriately identify the monthly rates authorized herein. These inserts shall be distributed to customers with the first billing containing the rates authorized herein. A copy of such inserts shall be filed with the Commission.
5. That Wisconsin Fuel and Light Company shall educate its customers regarding the authorized rate increase, and anticipated effective date, and shall provide its customers with an opportunity to mitigate bill increases consistent with the Findings of Fact.
6. That Wisconsin Fuel and Light Company shall stop amortizing the overspent funds in its conservation escrow account effective with implementation of the rates authorized by this order.

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7. That Wisconsin Fuel and Light Company shall work with Commission staff to develop an acceptable new bill format which identifies billing components as described in the Findings of Fact.

Dated at Madison, Wisconsin, _____

By the Commission:

Lynda L. Dorr
Secretary to the Commission

LLD:DJH:pr:n:\order\6640-gr-106 part b 3-19-98

See attached Notice of Appeal Rights

Notice of Appeal Rights

Notice is hereby given that a person aggrieved by the foregoing decision has the right to file a petition for judicial review as provided in s. 227.53, Stats. The petition must be filed within 30 days after the date of mailing of this decision. That date is shown on the first page. If there is no date on the first page, the date of mailing is shown immediately above the signature line. The Public Service Commission of Wisconsin must be named as respondent in the petition for judicial review.

Notice is further given that, if the foregoing decision is an order following a proceeding which is a contested case as defined in s. 227.01(3), Stats., a person aggrieved by the order has the further right to file one petition for rehearing as provided in s. 227.49, Stats. The petition must be filed within 20 days of the date of mailing of this decision.

If this decision is an order after rehearing, a person aggrieved who wishes to appeal must seek judicial review rather than rehearing. A second petition for rehearing is not an option.

This general notice is for the purpose of ensuring compliance with s. 227.48(2), Stats., and does not constitute a conclusion or admission that any particular party or person is necessarily aggrieved or that any particular decision or order is final or judicially reviewable.

Revised 4/22/91

APPENDIX A
(CONTESTED)

In order to comply with s. 227.47, Stats., the following parties who appeared before the agency are considered parties for purposes of review under s. 227.53, Stats.

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(Not a party but must be served)
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